Supreme Court, U.S.
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IN THE

Supreme Court of the United States

ZAPATA HERMANOS SUCESORES, S.A., PETITIONER,

v.

HEARTHSIDE BAKING CO. D/B/A MAURICE LENELL COOKY CO., RESPONDENT.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether attorneys' fees and litigation expenses qualify as a recoverable form of "loss" under Article 74 of the United Nations Convention on Contracts for the International Sale of Goods where such fees and expenses are foreseeable to the breaching party as a possible consequence of the breach at the time of contracting.

2. Whether the court of appeals, consistent with decisions of the First and Third Circuits, but in conflict with those of the Second, Fourth, Fifth, Sixth, Eighth, Ninth, Tenth, Eleventh and Federal Circuits, erred in holding that federal courts lack the inherent power to sanction a party for bad faith conduct where such conduct is potentially sanctionable by statute or rule.

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PETITION FOR A WRIT OF CERTIORARI

Zapata Hermanos Sucesores, S.A. respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The decision of the court of appeals (App., *infra*, 1a-10a) is published at 313 F.3d 385. The decisions of the district court (App., *infra*, 11a-32a) are reported at 2001 WL 1000927 and 2002 WL 398521.

JURISDICTION

The judgment of the court of appeals was entered on November 19, 2002. A timely petition for rehearing and suggestion of rehearing en banc was denied on January 9, 2003. App., *infra*, 33a-34a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The United Nations Convention on Contracts for the International Sale of Goods, 15 U.S.C.A. App., is reproduced, in pertinent part, at App., *infra*, 35a-36a.

STATEMENT

1. Petitioner Zapata is a family-owned manufacturer of tin products located in Mexico City, Mexico. Respondent Maurice Lenell Cooky Co. is a producer of baked goods located in Chicago, Illinois. From 1996 to 1999, Zapata sold to Lenell 1.6 million specially manufactured cookie tins that Lenell ordered at a purchase price of approximately $950,000. Lenell received, accepted and used the cookie tins without complaint, but failed to pay for them. In early 1999, Zapata informed Lenell that it would not accept any further orders until Lenell paid for the tins it already received. Lenell responded by threatening that if Zapata did not continue to fill new orders, Zapata would never be paid because "former suppliers [do not] have any priority for payment."App., *infra*, 21a. Lenell then made good on its threat, never paying for the tins even though its own accounting records showed the money was owed. *Id.*

Zapata thus was forced to bring this action seeking payment of the purchase price plus contractually specified interest, pursuant to the United Nations Convention on Contracts for the International Sale of Goods, 15 U.S.C.A. App. ("CISG"). Under Article 74 of the CISG, which permits the recovery of all "loss[es] suffered * * * as a consequence of the breach * * * which the party in breach ought to have foreseen at the time of the conclusion of the contract * * * as a possible consequence of the breach of contract," Zapata sought recovery of its attorneys' fees and litigation expenses as damages foreseeably caused by Lenell's unjustified refusal to pay.

2. In the litigation, Lenell continued to make good on its threat by making it as difficult and expensive for Zapata to obtain payment. For instance, the district court found that Lenell denied all liability throughout the litigation when it "had absolutely no defense to payment of invoices totaling $857,796.90."App., *infra*, 21a. The court also found that

> Lenell dramatically expanded the scope of this litigation, including discovery and the trial, by forcing Zapata to undertake the difficult and time-consuming task of proving its entitlement to payment for more than 100 invoices that Lenell knew full well it was obligated to pay.

Ibid. Lenell also "hopelessly complicated" the litigation "by creating the need to investigate, prepare for and successfully oppose Lenell's late-advanced, convoluted, multifarious and (regrettably) baseless defenses and counterclaims." *Id.*, 25a.

Following discovery, the case was tried to a jury. At the close of the evidence, the district court granted Zapata judgment as a matter of law as to 93 of the 110 unpaid invoices totaling $857,796.90, rejecting virtually all of Lenell's defenses as a matter of law (rulings that Lenell did not appeal). The court also granted Zapata judgment as a matter of law on all but two of Lenell's counterclaims (rulings that Lenell also did not appeal). The jury then returned a verdict in Zapata's favor on its claim for contractual interest and against Lenell on its remaining

counterclaims. The court entered final judgment in Zapata's favor in the amount of $1,176,350.95.

After trial, and by stipulation of the parties, the district court considered the recoverability of Zapata's attorneys' fees. The court held that these fees were recoverable under CISG Article 74 because Lenell had needlessly forced Zapata to incur them, and Lenell had stipulated that "[a]s of the dates when Lenell issued its purchase orders * * *, Lenell foresaw or should have foreseen that if Lenell failed to pay for the tins that it ordered, received and accepted, Zapata would incur litigation costs including attorneys' fees, to seek payment of the invoices for said tins." App., *infra*, 13a.

The court found that the CISG, as a treaty "defining the relationships between nationals of different signatory countries, calls for uniformity of construction," and mandates "universality rather than a purely home-town rule as to the awardability of attorneys' fees under the Convention." App., *infra*, 14a. The court thus rejected Lenell's request for "the parochial application of the American rule" that each party bear its own litigation costs. As the court explained, while "the norm in our own judicial system is for each litigant in a purely United-States-based dispute to bear the burden of its own legal expense, that does not at all equate to the notion that public policy (or anything else) forbids a federal court's judicial enforcement of a different rule that is appropriately brought into play." *Id.*, 15a. The court thus held that "when purely parochial considerations are put aside (quite properly so), it cannot be gainsaid that the normal unstrained reading of Article 74 coupled with the above-quoted Stipulation calls for Zapata's recovery of its attorneys' fees as foreseen consequential damages," and that "[w]hen the searchlight of analysis is thus properly focused on the language of the Convention without any inappropriate overlay from the American Rule, the question becomes a simple one." *Id.*, 15a-16a. The court also noted that the contrary position "is clearly refuted by the decisions cited at

Zapata Mem. 4 from other countries' courts and arbitral tribunals" holding that attorneys' fees are recoverable under Article 74. *Id.*, 16a.

The district court also imposed Zapata's attorneys' fees as a sanction against Lenell pursuant to the court's inherent power, citing *Chambers v. NASCO*, 501 U.S. 32, 53 (1991). The court found that Lenell had engaged in "extreme bad faith" conduct "both before and during this litigation" by "mak[ing] it as difficult and expensive as possible for Zapata to receive its money in this litigation" and by "dramatically and needlessly expanding the scope of this litigation * * * by interposing a host of unwarranted roadblocks" through "late-advanced, convoluted, multifarious and (regrettably) baseless defenses and counterclaims." App., *infra*, 20a-22a, 23a, 25a. The court found that by asserting this multitude of "baseless" defenses and counterclaims, Lenell succeeded in "dragging out what should have been a relatively simple collection case for goods sold and delivered * * * into an enormously time-consuming and expensive lawsuit." *Id.*, 23a.

4.a. The Seventh Circuit, with Judge Posner writing for the panel, affirmed the judgment of liability against Lenell but reversed the district court's award of attorneys' fees. The court of appeals held that the recoverability of attorneys' fees under Article 74 is not a "substantive" question governed by the CISG but rather a "procedural" question controlled by domestic law (in this case the "American rule" that each party bear its own litigation costs). According to the court of appeals, the CISG "is about contracts, not about procedure," and the recoverability of attorneys' fees is exclusively a "procedural" issue because "[t]he principles for determining when a losing party must reimburse the winner for the latter's expense of litigation are usually not a part of a substantive body of law, such as contract law, but a part of procedural law." App., *infra*, 3a.

Without addressing any of the more than 275 decisions by courts and arbitral tribunals in other CISG signatory nations

interpreting Article 74[1]—decisions that Zapata cited and the district court relied upon—the court of appeals found that "[t]here is no suggestion in the background of the Convention or the cases under it that 'loss' was intended to include attorneys' fees, but no suggestion to the contrary either." The court also found that "the question of attorneys' fees [is] not 'expressly settled' in the Convention," and that "there are no 'principles' that can be drawn out of the provisions of the Convention for determining whether 'loss' includes attorneys' fees; so by the terms of the Convention itself the matter must be left to domestic law." App., *infra*, 2a-3a. Thus, relying solely on domestic cases applying the American rule, the court held that "'loss' does not include attorneys' fees incurred in the litigation of a suit for breach of contract." App., *infra*, 2a.

b. The court of appeals also reversed the district court's inherent power sanction. Without questioning the district court's findings of bad faith, the court of appeals set aside the sanction on the ground that "[t]he inherent authority of federal courts to punish misconduct before them is not a grant of authority to do good, rectify shortcomings of the common law * * *, or undermine the American rule on the award of attorneys' fees to the prevailing party in the absence of statute." The court of appeals held that the inherent power to sanction instead "is a residual authority, to be exercised sparingly, to punish misconduct (1) occurring in the litigation itself, not in the events giving rise to the litigation * * *, and (2) not adequately dealt with by other rules, most pertinently here Rules 11 and 37 of the Federal Rules of Civil Procedure, which Lenell has not been accused of violating." App., *infra*, 7a-8a. The court thus held that because "Lenell has not been accused of

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[1] See Felemegas (Australia), *An Interpretation of Article 74 CISG by the U.S. Circuit Court of Appeals*, to be published in 15 PACE INT'L L. REV. (Spring 2003) (http://cisgw3.law.pace.edu/cisg/biblio/felemegas4.html) (collecting decisions).

violating" Rules 11 or 37, the district court lacked the inherent power to sanction Lenell for bad faith conduct.

The Seventh Circuit saw no need to "pick through the record to see whether some of the counterclaims or other moves by Lenell during the trial were sanctionable apart from Rule 11 and Rule 37." App., *infra*, 9a. The court instead remanded for further proceedings, noting "by way of guiding further proceedings on remand * * * that to the extent that [Rules 11 and 37] place limits on the award of sanctions under them (for example by the provision of safe harbors in Rule 11), those limitations are equally limitations on inherent authority, which may not be used to amend the rules." App., *infra*, 9a.

REASONS FOR GRANTING THE PETITION

I. THE SEVENTH CIRCUIT'S DECISION THAT ATTORNEYS' FEES ARE NOT RECOVERABLE UNDER ARTICLE 74 DISREGARDS THE CONTRARY DECISIONS OF OTHER SIGNATORY NATIONS AND THE PLAIN LANGUAGE OF THE CISG.

This case presents the Court with an opportunity to address for the first time the United Nations Convention on Contracts for the International Sale of Goods. As an international uniform commercial code ratified by the United States in 1986, the CISG "applies to contracts of sale of goods between parties whose places of business are in different States: (a) when the States are Contracting States; or (b) when the rules of private international law lead to the application of the law of a Contracting State." Art. 1(1). With 62 signatory nations, including most of the major commercial jurisdictions of the world, the CISG today is one of the most dominant sources of private international law, with a rapidly developing jurisprudence involving thousands of judicial and arbitral

decisions worldwide.[2] See generally Schlechtriem, COMMENTARY ON THE UN CONVENTION ON THE INTERNATIONAL SALE OF GOODS (Oxford 2d ed. 1998).

As the United States recognized in its instrument of ratification, the CISG "sets out substantive provisions of law to govern the formation of international sales contracts and the rights and obligations of the buyer and seller." 15 U.S.C.A. App. It also specifies the rules of construction that signatories must follow in applying the CISG. Article 7(1) requires that in any "interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade." To ensure this "uniformity in [the CISG's] application," Article 7(2) requires that any

> [q]uestions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.

The question presented here is whether attorneys' fees are a recoverable form of consequential "loss" under CISG Article 74, where such fees are foreseen by a breaching party at the time of contracting as a possible consequence of the breach. The Seventh Circuit held that because attorneys' fees are not explicitly mentioned in Article 74, their recoverability is not "expressly settled" by the CISG and is governed by domestic law, *i.e.*, the "American rule" of attorneys' fees.

As we demonstrate below, the court of appeals' decision cannot be squared with the plain language of the CISG and disregards numerous decisions of other CISG signatory nations *consistently* holding that attorneys' fees *are* recoverable under

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[2] Decisions applying the CISG are catalogued in a database maintained by Pace University Law School. See http://www.cisg.law.pace.edu.

Article 74. In conflict with decisions of other circuits, the court also disregarded the interpretative requirements of CISG Article 7(1) by utilizing a rule of *domestic* law (*i.e.*, the "American rule" of attorneys' fees) to interpret Article 74 while ignoring general principles of the CISG that inexorably lead to the contrary reading of Article 74 adopted by the district court.

The international significance of the Seventh Circuit's decision cannot be overstated. It already has generated worldwide controversy and attention, including foreign requests for Supreme Court review.[3] This Court's review in fact is vitally needed not only to resolve the international split of authority created by the Seventh Circuit over the meaning of Article 74—"perhaps the most important remedy available under the Convention" (Felemegas (Australia), *An Interpretation of Article 74 CISG by the U.S. Circuit Court of Appeals*, to be published in 15 PACE INT'L L. REV. (Spring 2003) (available at

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[3] See, *e.g.*, Schlechtriem (Germany), *Attorneys' Fees as Part of Recoverable Damages*, 14 PACE INT'L L. REV. 205, 205 (2002) (noting that the decision below "deserves the greatest attention"); Vanto (Finland), *Attorneys' Fees as Damages in International Commercial Litigation*, to be published in 15 PACE INT'L L. REV. (Spring 2003) (available at http://www.cisg.law.pace.edu/cisg/biblio/vanto1.html) (discussing significance of this case under Finnish law, and noting that internationally this "case has garnered major attention," "possibly * * * because the case emanates from the United States, a jurisdiction which so far does not have a large CISG jurisprudence but whose rulings resonate throughout the commercial community"). See also, *e.g.*, Felemegas, 15 PACE INT'L L. REV. (noting that this case "has generated a healthy academic debate"); Felemegas, *The Award of Counsel's Fees Under Article 74 CISG, in* Zapata Hermanos Sucesores v. Hearthside Baking Co. (2001), 6 VINDOBONA J. INT'L COMM. L. & ARB. 30, 39 (2002); Colligan (U.S.), *Applying the General Principles of the United Nations' Convention on Contracts for the International Sale of Goods to Fill the Article 78 Interest Rate Gap in* Zapata Hermanos, S.A. v. Hearthside Baking Co. Inc. (2001), 6 VINDOBONA J. INT'L COMM. L. & ARB. 40 (2002); Flechtner (U.S.), *Recovering Attorneys' Fees as Damages Under the U.N. Sales Convention*, 22 NW. J. INT'L L. & BUS. (2002); Lookofsky (Denmark), Zapata Hermanos v. Hearthside Baking, 6 VINDOBONA J. INT'L COMM. L. & ARB. 27 (2002).

http://cisgw3.law.pace.edu/cisg/biblio/felemegas4.html) (collecting decisions))—but also to clarify more generally the interpretive principles that courts must follow in construing the CISG, including the extent to which courts may rely on domestic law to interpret the CISG's express terms (in this case the word "loss" in Article 74). This case presents an ideal opportunity for this Court to resolve these significant controversies and bring needed clarity to this important area of private international law.

A. The Seventh Circuit's Decision Improperly Disregards The Decisions Of Tribunals In Other CISG Signatory Nations And Misapplies The Interpretative Requirements Of CISG Article 7.

This Court held in *Air France v. Saks*, 470 U.S. 392, 399-404 (1985), that in cases involving international treaties, "considerable weight" must be given to decisions of foreign tribunals so as "to give the specific words of the treaty a meaning consistent with the shared expectations of the contracting parties." That holding applies with particular force to the CISG, which was created for the "expressly stated goal of developing uniform international contract law to promote international trade" (*Asante Tech., Inc. v. PMC-Sierra, Inc.*, 164 F. Supp. 2d 1142, 1151 (N.D. Cal. 2001)), and to provide greater legal certainty to the international sale of goods—transactions where "uncertainty will almost inevitably exist." *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 516 (1974).

The CISG mandates "uniformity in its application," requiring that unaddressed questions be "settled in conformity with the general principles" of the CISG and, alternatively, according to principles of private international law. Art. 7. This Court's jurisprudence and the CISG thus require, at a bare minimum, that courts applying the CISG consider decisions in other signatory nations. See Cook, *The U.N. Convention on Contracts for the International Sale of Goods: A Mandate to Abandon Legal Ethnocentricity*, 16 J.L. & COMM. 2:257, 261

(1997) ("Article 7(2) * * * directs courts to be guided by 'the laws applicable by virtue of the rules of private international law,' a gap filling mechanism that permits, even requires, review of relevant U.S. and foreign decisions"); Flechtner, *The Several Texts of the CISG in a Decentralized System: Observations on Translations, Reservations and Other Challenges to the Uniformity Principle in Article 7(1)*, 17 J.L. & COMM. 187, 215 (1998) ("The key to honoring the mandate of the uniformity principle in Article 7(1) is ensuring that the deliberations of decision-makers are informed by knowledge of how pertinent issues have been handled by others, particularly courts and commentators representing different legal traditions").

These express uniformity requirements and related concerns "of international comity, respect for the capacities of foreign and transnational tribunals, and sensitivity to the need of the international commercial system for predictability," all require that signatories abide by the CISG's international rules and principles "even assuming that a contrary result would be forthcoming in a domestic context." *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 629 (1985).

In this case, the court of appeals ignored these obligations, disregarding *multiple* decisions of judicial and arbitral tribunals outside the United States that not only were cited by Zapata, but were *relied upon* by the district court, all of which *consistently* hold that attorneys' fees are recoverable under Article 74.

For instance, the German Court of Appeal in Case No. 17 U 146/93 (OLG Düsseldorf Jan. 14, 1994), held that attorneys' "fees in general could be recovered under Article 74 CISG," *including* attorneys' fees that were not recoverable under local law.[4] Similarly, the Commercial Court of Switzerland has held that under Article 74, "all costs incurred in the reasonable pursuit of a claim are refundable" and that

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[4] The foreign authorities cited herein are available on the Internet. Web addresses for these decisions are reproduced in the Table of Authorities.

"pre-procedural legal costs are part of recoverable damages as long as the breach of contract gave sufficient rise for such." No. OR.97.00056 (Dec. 19, 1997) (citing Schlechtriem/Stoll, Art. 74, at 14). Accord Decision of German District Court (Amtsgericht) Viechtach in Case No. 1 C 419/01 (Apr. 11, 2002) (holding that "[t]he term 'loss' in Art. 74 sent. 1 CISG, encompasses the cost of pursuing one's rights," and that the seller there "was entitled to commission an attorney, because the [buyer] persistently refused payment").[5] See also Felemegas, 15 PACE INT'L L. REV. ("There is international case law and arbitral support for recovery of losses incurred as legal fees prior to or during litigation by a successful plaintiff in a contractual dispute by the CISG pursuant to the substantive law provisions of Art. 74"). This weight of international authority is also confirmed by the fact that Lenell has never cited a single decision by any tribunal anywhere in the world even suggesting, let alone holding, that attorneys' fees are not recoverable under Article 74.

There also is strong support in the literature for the recoverability of attorneys' fees under Article 74. For instance, Professor Schlechtriem, perhaps the leading international scholar on the history and meaning of the CISG, agrees with the district court below that under Article 74, "the costs of attorneys' fees is certainly foreseeable at the time of conclusion of the contract and thus a part of the risk undertaken."

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[5] Accord, *e.g.*, Hamburg Arbitration Proceeding (June 21, 1996) (holding that "independent" of domestic German law, attorneys' fees are recoverable damages under "Art. 61(1) in connection with Art. 74 CISG"); Case No. A3 1998 153 (District Court of Zug, Switzerland Feb. 25, 1999) (holding that "debt collection costs" are recoverable under Article 74); Case No. 2 C 22/97 (District Court of Berlin-Tiergarten, Germany Mar. 13, 1997) (holding that "damages under article 74 CISG include court and lawyer's fees"). Likewise, an Arbitral Tribunal of the International Commercial Arbitration Court of the Russian Federation Chamber of Commerce and Industry has held that attorneys' fees and costs are recoverable under Article 74. See Case No. 227/1996 (Mar. 22, 1999).

Schlechtriem, 14 PACE INT'L L. REV. at 205. Accord Felemegas, 6 VINDOBONA J. INT'L COMM. L. & ARB. at 39 (concluding that the district "court in *Zapata* correctly treated the recovery of counsel's fees (as part of damages under the Convention) as a substantive issue governed by the agreement of the parties to the contract and supplemented by the provisions of the Convention").

Consistent with the mandate of Article 7, the district court properly considered the international precedent described above. The court of appeals, by contrast, simply ignored it. See Felemegas, 15 PACE INT'L L. REV. (criticizing the Seventh Circuit below because it "made no reference at all to CISG jurisprudence"). The Seventh Circuit thus not only created an international split of authority where none had previously existed, but also laid the groundwork for further conflict by holding that the substantive scope of Article 74—and in particular the meaning of "loss"—is to be governed by *domestic* law. Such disregard of the interpretive mandates of Article 7 must not be tolerated. As the district court held, Article 7 "mandate[s] universality rather than a purely home-town rule as to the awardability of attorneys' fees under the Convention." App., *infra*, 14a. Indeed, its very purpose was to provide "a means for interpreters to develop the law under an international convention in a manner entirely free from the influence of domestic legal norms." Van Alstine, *Dynamic Treaty Interpretation*, 146 U. PA. L. REV. 687, 733 (1998).

It may be that in a purely domestic case the American rule of attorneys' fees would govern. But this is *not* a domestic case, and a local preference for the American rule cannot override the U.S. obligation to adhere to and *promote* the international legal standards of the CISG. See Vienna Convention on the Law of Treaties, Art. 27, 26 UNTS 1155, at 331 (1980) ("[a] Party may not invoke the provisions of its internal law as justification for its failure to perform a treaty"). As this Court recognized long ago, "[w]e cannot have trade and commerce in world markets

and international waters exclusively on our terms, governed by our laws, and resolved in our courts." *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 9 (1972).[6]

The CISG was crafted as a "floodgate against an all too broad recourse to domestic law," and to "prevent an all too hasty resort to domestic regulations and legal custom." Schlechtriem, UNIFORM SALES LAW: THE UN-CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS 37 (1986). Its "primary goal was to create *uniformity* in the rules for international sales, in order to supplant the complex and difficult-to-predict system that subjected international sales to the varying provisions of national sales laws." Flechtner, 17 J.L. & COMM. at 187. The CISG's "very mandate to interpreters is to bring about international uniformity in the regulated field of law." Van Alstine, at 701.

The court of appeals' improper use of domestic law to interpret the CISG also is squarely at odds with decisions of other circuits that properly have refused to apply domestic rules in CISG cases. For instance, in *MCC-Marble Ceramic Center v. Ceramica Nuova D'Agostino*, 144 F.3d 1384, 1391 (11th Cir. 1998), the Eleventh Circuit refused to apply the domestic parol evidence rule in a CISG case because:

> One of the primary factors motivating the negotiation and adoption of the [Convention] was to provide parties to international contracts for the sale of goods with some degree of certainty as to the principles of law that would govern potential disputes and remove the previous doubt regarding which party's legal system

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[6] The court of appeals believed that it "would produce anomalies" if a prevailing plaintiff could potentially recover its attorneys' fees under Article 74 while a prevailing defendant would not. App., *infra*, 4a. In fact, there is no anomaly at all when one considers that Article 74 is a *damages* provision—not a fee-shifting statute. It is hardly anomalous that only plaintiffs are permitted to recover damages since it is generally only they who allegedly have suffered harm.

> might otherwise apply. Courts applying the [Convention] cannot, therefore, upset the parties' reliance on the Convention by substituting familiar principles of domestic law when the Convention requires a different result. We may only achieve the directives of good faith and uniformity in contracts under the [Convention] by interpreting and applying the plain language of article 8(3) as written * * *.

Similarly, in *Geneva Pharmaceuticals Technology Corp. v. Barr Laboratories*, 201 F. Supp. 2d 236, 287 (S.D.N.Y. 2002), the court recognized that the CISG adopted a different form of promissory estoppel than that of U.S. law, but refused to apply the U.S. rule because "to apply an American or other version of promissory estoppel * * * would contradict the CISG and stymie its goal of uniformity." The court of appeals below erred for precisely this reason.

In short, the Seventh Circuit's decision "failed in its approach to the interpretation of the CISG because it did not evidence any attention at all to the several hundred available international cases on CISG Art. 74, citing solely U.S. domestic case law in support of the conclusion that 'loss' does not include attorneys' fees." Felemegas, 15 PACE INT'L L. REV. This patent misapplication of the CISG must be reversed.

B. The Court Of Appeals Misapplied The Plain Language Of CISG Article 74 And Disregarded Applicable "General Principles" Of The CISG.

CISG Article 74 provides that a party aggrieved by a contractual breach is entitled to recover for all "loss[es] which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of contract." App., *infra*, 36a. In this case, the district court's holding that Zapata's attorneys' fees qualify as a recoverable "loss" easily comports with the plain language of Article 74.

Lenell refused to pay for $950,000 in specially manufactured goods that it received, accepted and used, knowing full well that Zapata would have no choice but to file suit to obtain payment. Lenell even *stipulated* that at the time of contracting it "foresaw or should have foreseen that if Lenell failed to pay for the tins that it ordered, received and accepted, Zapata would incur litigation costs including attorneys fees, to seek payment of the invoices for said tins." App., *infra*, 13a. As the district court correctly held, "when purely parochial considerations are put aside (quite properly so), it cannot be gainsaid that the normal unstrained reading of Article 74 coupled with the above-quoted Stipulation calls for Zapata's recovery of its attorneys' fees as foreseen consequential damages." App., *infra*, 15a-16a.

The court of appeals reversed, holding simply that because "attorneys' fees" are not specifically mentioned in Article 74, their recoverability under Article 74 is not "expressly settled" by the CISG and is therefore a "procedural" question governed by "domestic law." App., *infra*, 3a. Thus, applying the "American rule," the court held that attorneys' fees are not a recoverable form of "loss" under Article 74. As we demonstrate below, this reasoning is fundamentally flawed.

To begin with, the Seventh Circuit erred in holding that the recoverability of attorneys' fees under Article 74 is not "expressly settled" by the CISG. Article 74 broadly provides for the recovery of *all* foreseeable "loss[es]," "using simple, non-nation specific language." *St. Paul Guardian Ins. Co. v. Neuromed Med. Sys. & Support*, 2002 WL 465312, *3 (S.D.N.Y. Mar. 26, 2002). As the Austria Supreme Court has held, "[u]nder the second sentence of Art. 74, a claim for damages is *only* limited by the foreseeability of the loss for the party in breach." Case No. 1 Ob 292/99v (Apr. 28, 2000) (emphasis added). Accord *Delchi Carrier SpA v. Rotorex Corp.*, 71 F.3d 1024, 1030 (2d Cir. 1995) (holding that Article 74 "provides that a contract plaintiff may collect damages to compensate for the full loss," "subject *only* to the familiar

limitation that the breaching party must have foreseen, or should have foreseen, the loss as a probable consequence") (emphasis added). As the Seventh Circuit itself acknowledged, nothing in the text or history of Article 74 suggests that attorneys' fees or any other category of loss is excluded from its scope. See Vanto, 15 PACE INT'L L. REV. (while Article 74 does not mention attorneys' fees, "it does not rule out attorneys' fees as damages either").

While attorneys' fees are not specifically mentioned in Article 74, this omission is meaningless because Article 74

> does not expressly mention *any* category of loss — apart from "loss of profit." The nature of the provision in Article 74 CISG is inclusive, not exhaustive. Furthermore, the voluminous case law on Article 74 documents the fact that there are many different categories of loss recoverable as damages, none of which is specifically mentioned in the text of Article 74. Thus, it is questionable whether it is proper for a court to single out one non-specific mention of a category of loss (in this case, "attorneys' fees") when the general approach of Article 74 CISG is not to specifically mention any of the categories of loss encompassed by its express language.

Felemegas, 15 PACE INT'L L. REV. Thus, Article 74 addresses attorneys' fees as a foreseeable form of loss as explicitly as it addresses any other type of loss.

The Seventh Circuit's holding that the recoverability of attorneys' fees under Article 74 is not "expressly settled" within the meaning of CISG Article 7 also makes no sense because the question turns entirely on the meaning of a word used in the Convention itself, *i.e.*, "loss." Regardless of any ambiguity in its meaning (and there is none), the definition of such an express term cannot possibly be regarded as falling outside the scope of the Convention. After all, how can it be that the meaning of a Convention term could be governed by the divergent domestic

laws of each signatory nation? Article 74 would have 62 different meanings, and it would be impossible to achieve any "uniform" understanding of its scope—as the CISG requires.

The question here is *not* whether attorneys' fees are automatically recoverable as a "procedural" matter.[7] No one is suggesting that Article 74 is a fee-shifting statute. The question is whether attorneys' fees qualify as a recoverable form as *damages* where the foreseeability requirements of Article 74 are met. There can only be one uniform answer to that question, and it was incumbent upon the court of appeals to find that answer based on the text and principles of the Convention—not by resorting to local law. Indeed, "even where the inevitable substantive gaps appear, article 7(2) directs an adjudicator to seek answers on an international level, specifically in the values reflected in the convention itself." Van Alstine, at 733.

The Seventh Circuit also erroneously declared that "there are no 'principles' that can be drawn out of the provisions of the Convention for determining whether 'loss' includes attorneys' fees." App., *infra*, 3a. To the contrary,

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[7] The court of appeals also justified its reliance on domestic law by arguing that the recoverability of attorneys' fees is a "procedural" question. In fact, this Court has held at least twice that under federal law the recoverability of attorneys' fees is a *substantive* question. See *Alyeska Pipeline Serv. v. Wilderness Soc'y*, 421 U.S. 240, 259 n.31 (1975) (right to attorneys' fees is a "substantive" question for *Erie* purposes); *Chambers v. NASCO*, 501 U.S. 32, 53 (1991) (same). Moreover, the mere characterization of a question as "procedural" does not justify the application of domestic law to matters falling within the scope of the CISG. See Felemegas, 6 VINDOBONA J. INT'L COMM. L. & ARB. at 39 (treating the recovery of attorneys' fees under Article 74 as "a procedural issue to be settled by reference to either the *lex fori* or the otherwise applicable domestic law * * * goes against the plain meaning of the Convention's language and intent, as well as the available international jurisprudence"); Vanto, 15 PACE INT'L L. REV. ("If we * * * approach the matter in the context of the CISG, does it really matter if a national law calls an issue 'procedural' or 'material'* * *?").

> [b]y anybody's account, the "general principles" on which the Convention is based invoke broad concepts such as the requirement to interpret the Convention in "good faith" and to generally act "reasonabl[y]." In the context of the international character of the Convention, "good faith" mandates an interpretation that takes account of non-U.S. principles and interpretations developed by the other Contracting States to the Convention.

Cook, at 261. In this case, the decisions of other Contracting States consistently lead to the conclusion that foreseeable attorneys' fees are recoverable under Article 74. *Supra*, pp. 10-11 & n.5.

Moreover, the recoverability of attorneys' fees under Article 74 "is in accord with one of the most fundamental general principles upon which the Convention is based: *full compensation*." Felemegas, 15 PACE INT'L L. REV. (emphasis in original). Indeed, it is widely recognized that under Article 74, a plaintiff is entitled to recover its "full loss" in order to "place the aggrieved party in as good a position as if the other party had properly performed the contract." *Delchi*, 71 F.3d at 1029, 1030 (quoting Honnold, UNIFORM LAW FOR INTERNATIONAL SALES UNDER THE 1980 UNITED NATIONS CONVENTION 503 (2d ed. 1991)).[8]

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[8] Accord Schlechtriem, COMMENTARY 558 (Article 74 "does not define in more detail which are the losses for which compensation can be obtained. In order to identify the losses for which compensation may be demanded, regard must be had to the principle of full compensation for loss * * * in the context of the particular contract concerned"); UNCITRAL Secretariat Commentary to the 1978 Draft of the CISG, Comment No. 8 (endorsing "[t]he principle of recovery of the full amount of damages suffered by the party not in breach," subject only to the "important limitation" that the amount recovered "may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract"); Principles of International Commercial Contracts of the International Institute for the Unification of Private Law (UNIDROIT),

The district court below properly took these general principles into account, as Article 7 requires, in holding that one of the fundamental principles of the CISG is "to provide full relief" and "make whole" those aggrieved by contractual breaches, and that such "full compensation" can be "assured *only* by freeing [a plaintiff's] damages recovery from the burden of attorneys' fees." App., *infra*, 17a (emphasis in original). But despite the district court's reliance on these general principles and their wide acceptance among other courts, the Seventh Circuit again ignored them. This too was reversible error.

Construing "loss" in Article 74 to include attorneys' fees also advances the CISG's stated goal of promoting "good faith" in international trade by discouraging the sort of brazen contractual breaches that occurred here, and by also ensuring that the costs of litigation do not discourage non-breaching parties from asserting their rights.

In sum, the district court's award of Zapata's attorneys' fees as a recoverable "loss" easily comports with the plain language of Article 74, particularly given the parties' stipulation that those fees and expenses were foreseeable to Lenell at the time of contracting. The Seventh Circuit's reversal of that ruling reflects a fundamental misapplication of the CISG and its text.

C. Supreme Court Guidance Over The Proper Application Of The CISG Is Vital.

There is great confusion over the interpretive standards that courts must apply in construing the CISG. "Unfortunately, the guidance from the Supreme Court has been cryptic on this score." Van Alstine, at 709. "The consequence has been an application of divergent substantive norms precisely in the manner the adoption of the [CISG] was designed to prevent." *Id.* at 767. The Seventh Circuit's decision typifies this trend, prompting requests for Supreme Court review to "provide the

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Article 7.4.2 ("[t]he aggrieved party is entitled to full compensation for harm sustained as a result of the non-performance").

appropriate jurisprudential leadership and sound doctrinal clarity necessary for the proper interpretation and application of the Convention's provisions." Felemegas, 15 PACE INT'L L. REV.

The need for Supreme Court review is compelling not only to resolve the conflict over the meaning of Article 74, but also more generally to clarify the interpretative rules that courts must follow in applying the CISG, including the determination of when a "gap" exists within the meaning of Article 7, and the extent to which domestic law may be used to fill such gaps.

In the meantime, the Seventh Circuit's message to other CISG signatory nations is clear—that U.S. courts will continue to rely on rules of local law to interpret the CISG. Indeed, foreign authorities have lamented the Seventh Circuit's "disappointing" decision as revealing the "reflexes of the American judges," and for displaying the "symptoms associated with a narrow, national and, therefore, improper interpretation of the provisions of the Convention" by "trying to fit the body of law that is the CISG onto the bed that is American legal heritage which, by design, does not fit." Felemegas, 15 PACE INT'L L. REV. As other U.S. courts regrettably have done, the Seventh Circuit "consulted exclusively U.S. decisions and U.S. commentators. In its approach, no international trace, such as non-U.S. sources or methods of analysis, can be found anywhere." Cook, at 261.

Without Supreme Court intervention, "[t]he process of building a common international framework for understanding contracts, and thus escaping the pull of the 'homeward trend,' is * * * likely to be a long and difficult one." Flechtner, 17 J.L. & COMM. at 200, 204 (citing Honnold, DOCUMENTARY HISTORY OF THE UNIFORM LAW FOR INTERNATIONAL SALES 1 (1989)). Immediate intervention is therefore vital, for "[i]t is of utmost importance to the viability of the Convention that national concepts and labels do not hamper the uniformity that is critical for the functioning of the Convention and the

certainty that is crucial to the functioning of international trade." Vanto, 15 PACE INT'L L. REV.

Allowing the meaning of terms used in the CISG to be controlled by domestic law will have serious practical consequences. For instance, it will lead to forum shopping by encouraging parties to file suit in countries whose domestic law puts an expansive cast on Article 74. Defendants sued in U.S. courts also would have exclusive immunity against the payment of attorneys' fees as damages since the U.S. is the only CISG signatory to recognize the "American rule," thus encouraging breaching U.S. parties like Lenell to engage in precisely the sort of bad faith conduct that the CISG was meant to discourage.

The Seventh Circuit's reading of the CISG also makes it more difficult for parties to contract internationally by making it tougher to discern the CISG's default rules. "Article 6 guarantees party autonomy over both the conflict rules and the substantive law"; thus, "any rule of the Convention can be altered or rejected by the parties, even by standard contract terms." Schlechtriem, UNIFORM SALES LAW at 35. Thus, for instance, if parties wish to agree that each will bear its own attorneys' fees and expenses in any litigation, they are free to do so. "The underlying idea is that the parties, at the conclusion of the contract, should be able to calculate the risks and potential liability they assume by their agreement." *Id.*, 97. Such bargains are only possible, however, if the parties have a common understanding of the default rules against which they are contracting. Otherwise, the "CISG will be but a pitfall for the unwary." Behr, *The Sales Convention in Europe: From Problems in Drafting to Problems in Practice*, 17 J.L. & COMM. 263, 265-66 (1998). As this Court warned in *Scherk*, 417 U.S. at 516-17, "the dicey atmosphere of such a legal no-man's land would surely damage the fabric of international commerce and trade, and imperil the willingness and ability of businessmen to enter into international commercial agreements."

The Court should grant the petition to resolve these important questions and bring needed clarity to this vital area of private international law.

II. THE SEVENTH CIRCUIT'S HOLDING THAT THE DISTRICT COURT LACKED THE INHERENT POWER TO SANCTION LENELL'S BAD FAITH CONDUCT CONFLICTS WITH THIS COURT'S DECISION IN *CHAMBERS v. NASCO*, 501 U.S. 32 (1991), AND DECISIONS OF OTHER CIRCUITS.

A. The Circuits Are Deadlocked Over Whether Federal Courts Have The Inherent Power To Sanction Bad Faith Conduct That Is Otherwise Sanctionable By Statute Or Rule.

The Seventh Circuit's decision also raises the important and recurring question of whether a federal court may sanction, pursuant to its inherent power, a party for bad faith conduct even if such conduct is sanctionable under statutory or rules-based mechanisms. The need for Supreme Court review of this important issue is also compelling, as it has continuously recurred and deeply divided the Circuits. This case provides an ideal opportunity to put this controversy to rest as well.

In *Chambers v. NASCO*, 501 U.S. 32, 45-46 (1991), this Court held that "a court may assess attorney's fees when a party has 'acted in bad faith, vexatiously, wantonly, or for oppressive reasons,'" when a court finds "that fraud has been practiced upon it, or that the very temple of justice has been defiled," or when a party "shows bad faith by delaying or disrupting the litigation or by hampering enforcement of a court order." In such cases, "[t]he imposition of sanctions * * * transcends a court's equitable power concerning relations between the parties and reaches a court's inherent power to police itself, thus serving the dual purpose of 'vindicating judicial authority without resort to the more drastic sanctions available for contempt of court and making the prevailing party whole for expenses caused by his opponent's obstinacy.'" *Id.*

Chambers also held that a federal court is *not* "forbidden to sanction bad-faith conduct by means of the inherent power simply because that conduct could also be sanctioned under the statute or the Rules," and that "requiring a court first to apply Rules and statutes containing sanctioning provisions to discrete occurrences before invoking inherent power to address remaining instances of sanctionable conduct would serve only to foster extensive and needless satellite litigation, which is contrary to the aim of the Rules themselves." 501 U.S. at 50-51. The Court also noted, however, that while federal courts "ordinarily" should proceed under other rules or statutes where they are adequate, inherent power may be "safely" invoked "if in the informed discretion of the court, neither the statute nor the Rules are up to the task." *Id.* at 50.

The Circuits are hopelessly divided over the meaning of *Chambers* and the extent to which federal courts have the inherent power to sanction parties for bad faith conduct even if such conduct is potentially sanctionable by statute or rule.

In this case, the Seventh Circuit held that courts may *not* invoke their inherent power to sanction bad faith conduct unless such conduct cannot be "adequately dealt with by other rules, most pertinently here Rules 11 and 37 of the Federal Rules of Civil Procedure." The court also held that the procedural "limitations" of Rules 11 and 37 "are equally limitations on inherent authority" imposition of such sanctions. App., *infra*, 7a, 9a. This holding is consistent with rulings of the First and Third Circuits, which also have held that inherent power sanctions may only be imposed where a court finds that other sanctioning mechanisms are not "up to the task." See, *e.g.*, *United States v. One 1987 BMW 325*, 985 F.2d 655, 661 (1st Cir. 1993) ("When, as in this case, the Civil Rules limit the nature of the sanction that can be imposed, a court may not use its inherent powers to circumvent the Rules' specific provisions"); *Klein v. Stahl GMBH & Co.*, 185 F.3d 98, 108 (3d Cir. 1999) ("a trial court should consider invoking its inherent sanctioning powers only where no sanction established by the

Federal Rules or a pertinent statute is 'up to the task' of remedying the damage done by a litigant's malfeasance"); *Montrose Med. Group Sav. Plan v. Bulger*, 243 F.3d 773, 785 (3d Cir. 2001) (reversing for failure to consider rule- or statute-based sanctions before invoking inherent power).

The Seventh Circuit's holding irreconcilably conflicts, however, with those of the Second, Fourth, Fifth, Sixth, Eighth, Ninth, Tenth, Eleventh and Federal Circuits, which all have squarely held that federal courts *may* invoke their inherent power to sanction bad faith conduct *regardless* of whether such conduct is also sanctionable under statutes or rules. See, *e.g.*, *DLC Mgt. Corp. v. Town of Hyde Park*, 163 F.3d 124, 136 (2d Cir. 1998) (affirming inherent power sanction, and holding that "the fact that there may be a statute or rule which provides a mechanism for imposing sanctions of a particular variety for a specific type of abuse does not limit a court's inherent power to fashion sanctions, even in situations similar or identical to those contemplated by the statute or rule"); *In re Weiss*, 111 F.3d 1159, 1171 (4th Cir. 1997) ("A court may invoke its inherent power in conjunction with, or instead of, other sanctioning provisions such as [Bankruptcy] Rule 9011"); *Travelers Ins. Co. v. St. Jude Hosp.*, 38 F.3d 1414, 1418 (5th Cir. 1994) ("a court is not forbidden from sanctioning bad-faith conduct under its inherent powers simply because that conduct could also be sanctioned under § 1927 or the Federal Rules of Civil Procedure") (citing *Chambers*); *First Bank of Marietta v. Hartford Underwriters Ins. Co.*, 307 F.3d 501, 514 (6th Cir. 2002) ("In our view, *Chambers* should be read broadly to permit the district court to resort to its inherent authority to sanction bad-faith conduct, even if the court has not expressly considered whether such conduct could be sanctioned under all potentially applicable rules or statutes"); *Nick v. Morgan's Foods, Inc.*, 270 F.3d 590, 594 n.2 (8th Cir. 2001) ("the sanctioning provisions of Rule 16 and the district court's inherent power to sanction are not mutually exclusive. In *Chambers* * * * the Court rejected the appellant's contention

that the sanctioning provisions in the federal rules reflect a legislative intent to replace or foreclose resort to the courts' inherent power"); *Fink v. Gomez*, 239 F.3d 989, 994 (9th Cir. 2001) ("It is well settled * * * that the district court may, in its informed discretion, rely on inherent power rather than the federal rules or § 1927"); *RTC v. Dabney*, 73 F.3d 262, 267 (10th Cir. 1995) (same); *Thomas v. Tenneco Packaging*, 293 F.3d 1306, 1328 n.32 (11th Cir. 2002) ("as an alternative to a district court's inherent power, several federal provisions provide possible avenues for imposing sanctions upon errant attorneys who harass other attorneys during the course of litigation.* * * That sanctions may have been possible under these provisions, however, did not negate the district court's inherent power to levy sanctions against Munson for her misconduct"); *In re Mroz*, 65 F.3d 1567, 1575 (11th Cir. 1995) ("the 'inherent power of a court can be invoked even if procedural rules exist which sanction the same conduct,' for these rules are not substitutes for the inherent power") (quoting *Chambers*); *Pickholtz v. Rainbow Tech.*, 284 F.3d 1365, 1376-77 (Fed. Cir. 2002) ("express rules supplement, rather than displace, the court's inherent power. * * * *Chambers* thus permits, indeed requires, the court to separately consider Pickholtz's motion for attorney fees under its inherent power").

Courts on both sides of this split purport to find support for their position in *Chambers*. On the one hand, *Chambers* emphasized that a federal court is not "forbidden to sanction bad-faith conduct by means of the inherent power simply because that conduct could also be sanctioned under the statute or the Rules," and refused to "requir[e] a court first to apply Rules and statutes containing sanctioning provisions to discrete occurrences before invoking inherent power to address remaining instances of sanctionable conduct." On the other hand, the Court noted that "ordinarily" a court should rely on statutory or rules-based sanctioning mechanisms unless the court determines that "neither the statute nor the Rules are up to the task." 501 U.S. at 50-51. As the sheer magnitude and

frequency of this circuit split confirm, the federal courts have not been able to reach a consensus over the meaning of *Chambers*, and have no prospect of doing so without this Court's intervention.

B. The Circuits Are Also Split Over Whether Courts Can Consider Pre-Litigation Conduct In Sanctioning Bad Faith Conduct Pursuant To Their Inherent Power.

The Seventh Circuit's decision also squarely implicates a separate circuit split over the meaning of *Chambers*. The court held that the district court reversibly erred in basing its inherent power sanction, in part, on Lenell's pre-litigation conduct—to wit, Lenell's refusal to pay for goods it had ordered, received and used despite the fact that this debt was confirmed by "its own accounting records, and the fact that Lenell had absolutely no defense to payment of invoices totaling $857,796.90," such that Zapata "was forced to sue to collect for the unpaid sale price of its tins." App., *infra*, 19a. According to the Seventh Circuit, a federal court may not exercise its inherent power to sanction conduct "giving rise to the litigation * * * for then the punishment would be a product of substantive law." App., *infra*, 7a. This holding squarely conflicts with decisions of the Fifth, Sixth, Eighth and Ninth Circuits.

For instance, the Eighth Circuit has "adopted the view promulgated by various circuits that, in determining whether to award attorney fees based on the litigant's bad faith, 'the court may consider conduct both during and prior to the litigation, although the award may not be based solely on the conduct that led to the substantive claim.'" *Lamb Eng'g & Constr. Co. v. Nebraska Public Power Dist.*, 103 F.3d 1422, 1435 (1997) (quoting *McLarty v. United States*, 6 F.3d 545, 549 (8th Cir. 1993)). At least four other circuits agree. See, *e.g.*, *Sussman v. Bank of Israel*, 56 F.3d 450, 459 (2d Cir. 1995) ("[w]hile Rule 11 extends only to papers filed with the court, the court's inherent power is broader and would permit the court to impose

sanctions on the basis of related bad-faith conduct prior to the commencement of the litigation"); *Perales v. Casillas*, 950 F.2d 1066, 1071 (5th Cir. 1992) (same); *Ass'n of Flight Attendants v. Horizon Air Indus.*, 976 F.2d 541, 548-50 (9th Cir. 1992) (same); *Shimman v. Int'l Union of Operating Eng'rs*, 744 F.2d 1226, 1230, 1234 (6th Cir. 1984) (inherent power to sanction extends to bad faith pre-litigation conduct "necessitating that an action be filed," particularly in "a case where the defendant contumaciously refused to allow the plaintiff what was plainly owed, thus forcing the plaintiff to go to court"). Accord *Hall v. Cole*, 412 U.S. 1, 15 (1973) ("'bad faith' may be found, not only in the actions that led to the lawsuit, but also in the conduct of the litigation"); *United States ex rel. Yonker Constr. Co. v. Western Contracting Corp.*, 935 F.2d 936, 942 (8th Cir. 1991) ("Bad faith may occur during either contract performance or litigation"). *Cf. Towerridge, Inc. v. T.A.O., Inc.*, 111 F.3d 758, 765 (10th Cir. 1997) ("an award of attorneys' fees may not be premised solely on prelitigation conduct").

The circuits today regard this as a question left open by *Chambers*. In *Association of Flight Attendants*, for instance, the Ninth Circuit noted that *Chambers* "took care to explain that it was not reaching the issue whether a court had inherent power to sanction a party for bad faith conduct relating to the underlying cause of action—in that case, for breach of contract." 976 F.2d at 548. Accord *Towerridge*, 111 F.3d at 766 (noting that *Chambers* "declined" to reach this question "because that issue was not before it"); *Guevara v. Maritime Overseas Corp.*, 59 F.3d 1496, 1503 (5th Cir. 1995) (noting that "the *Chambers* majority expressed no opinion on the question of whether a federal court has the inherent power to impose sanctions for conduct giving rise to an underlying claim, rather than for bad-faith conduct during the litigation process"). The Seventh Circuit's decision squarely raises this open question since the district court relied in part on prelitigation misconduct that it found was directly related to Lenell's bad faith conduct in the litigation as well.

The Court should grant the petition to resolve these significant splits of authority, each of which independently warrants Supreme Court review.

C. The District Court Properly Sanctioned Lenell For Bad Faith Litigation Conduct.

The district court sanctioned Lenell pursuant to its inherent power based on detailed findings that Lenell engaged in "extreme bad faith" by misusing the judicial system to avoid paying a debt it knew that it owed. The court specifically found that Lenell carried out this scheme by "dramatically and needlessly expanding the scope of this litigation," and "mak[ing] it as difficult and expensive as possible for Zapata to receive its money in this litigation * * * by interposing a host of unwarranted roadblocks," including "late-advanced, convoluted, multifarious and (regrettably) baseless defenses and counterclaims." App., *infra*, 20a-25a. By these repeated acts of bad faith, the court found that Lenell "dragg[ed] out what should have been a relatively simple collection case for goods sold * * * into an enormously time-consuming and expensive lawsuit," *id.*, 23a, acting as if the judicial system "created a sort of iron curtain that justified Lenell's continued stiffing of its creditor as to the entire amount of a very large outstanding (and to a large extent undisputed) obligation." C.A. App. 11.

These detailed findings—none of which the court of appeals disturbed—amply supported the court's sanction because the cited misconduct pervaded the entire litigation. *Chambers* affirmed just such a sanction, holding that even though "the District Court could have employed Rule 11 to sanction Chambers for filing 'false and frivolous pleadings,' and that some of the other conduct might have been reached through other Rules," the sanction of case-wide attorneys' fees was proper because (as in this case) the defendant's "entire course of conduct throughout the lawsuit evidenced bad faith and an attempt to perpetrate a fraud on the court, and the conduct sanctionable under the Rules was intertwined within conduct that only the inherent power could address." 501 U.S. at 50-51.

It is true that Zapata did not seek sanctions under Rules 11 or 37 because Lenell's misconduct could only be confirmed through full discovery and trial, after which it became obvious that Lenell never had any factual or legal basis for asserting its multitude of defenses and counterclaims. But whether Zapata could have sought sanctions under Rules 11 and 37 is beside the point, for the district court's inherent power to sanction Lenell's bad faith conduct was entirely distinct from the sanctioning power granted by Rules 11 and 37.

The "central purpose" of rules-based sanctioning mechanisms like Rule 11 "is to deter baseless filings in district court." *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 393 (1990). The inherent power to sanction bad faith conduct, by contrast, "transcends a court's equitable power concerning relations between the parties and reaches a court's inherent power to police itself, thus serving the dual purpose of 'vindicating judicial authority without resort to the more drastic sanctions available for contempt of court and making the prevailing party whole for expenses caused by his opponent's obstinacy.'" *Chambers*, 501 U.S. at 45-46. It is precisely for this reason that a federal court is not "forbidden to sanction bad-faith conduct by means of the inherent power simply because that conduct could also be sanctioned under the statute or the Rules." *Id.* at 50. In this case, however, the Seventh Circuit not only held that inherent power sanctions may only be sought where other sanctioning mechanisms are inadequate, but that the procedural requirements of Rules 11 and 37 apply *equally* to inherent power sanctions. This decision cannot be squared with *Chambers*, and should be reversed.

D. The Court Of Appeals' Decision Raises Recurring Issues Of Great Practical Importance.

The prejudice to petitioner from the splits of authority described above are readily apparent. Had this litigation taken place in any of the eight circuits that do not constrain the courts' inherent sanctioning power, the sanction below would have been affirmed. In addition, it is now impossible for petitioner to

comply with the Seventh Circuit's mandate that petitioner proceed under Rule 11 since Zapata cannot now satisfy the Rule's safe harbor provisions. See Fed. R. Civ. P. 11.

Beyond the contours of this case, the question of whether a federal court may exercise its inherent power to sanction bad faith litigation conduct that is potentially sanctionable under other mechanisms is one of great practical significance. The relationship between the inherent power doctrine and statutory or rules-based sanctions must be clearly defined for other pending and future cases so that parties aggrieved by bad faith conduct can confidently assess their options for seeking redress.

From the sheer number of cases that have recently addressed this issue, it is also apparent that absent Supreme Court review, this question will continue to plague the federal courts. This case provides an ideal opportunity to resolve these important controversies. The Court should grant the petition, and reverse the decision of the court of appeals.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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